No. 18-489

IN THE

# Supreme Court of the United States

BRADLEY WESTON TAGGART,

*Petitioner,*

*v.*

SHELLEY A. LORENZEN, ET AL.,

*Respondents.*

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

## BRIEF OF THE NATIONAL CONSUMER BANKRUPTCY RIGHTS CENTER AND THE NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS AS AMICI CURIAE IN SUPPORT OF PETITIONER

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Dated: February 26, 2019

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## TABLE OF CONTENTS


TABLE OF AUTHORITIES ..... ii

INTEREST OF AMICUS CURIAE ..... 1

SUMMARY OF ARGUMENT ..... 2

STATUTORY FRAMEWORK ..... 4

ARGUMENT ..... 6

I. *TAGGART* CREATES A BROAD EXCEPTION TO THE DISCHARGE INJUNCTION THAT RENDERS IT VIRTUALLY MEANINGLESS. ..... 6

II. BASED ON THE *TAGGART* STANDARD, COURTS IN THE NINTH CIRCUIT HAVE CONSISTENTLY ABSOLVED CREDITORS OF LIABILITY FOR DISCHARGE VIOLATIONS BASED ON THEIR SELF-PROCLAIMED "GOOD FAITH." ..... 8

III. THE *TAGGART* TEST REWARDS PURPOSEFUL IGNORANCE OF BANKRUPTCY LAW. ..... 15

IV. CREDITORS' STATE OF MIND SHOULD BE IRRELEVANT WHEN DETERMINING COMPLIANCE WITH THE DISCHARGE INJUNCTION. ..... 17

CONCLUSION ..... 22

ADDENDUM - *Morning Star Company v. Benech (In re Benech)*, 17-CV-05100-LHK (N.D. Cal., July 25, 2018) ..... 1

## TABLE OF AUTHORTIES

CASES:

*Banco Popular, North America v. Kanning*,
638 Fed. Appx. 328 (5th Cir. 2016) ..... 14, 22

*Bessette v. Avco Fin. Servs.*,
230 F.3d 439 (1st Cir. 2000) ..... 6

*Board of Trade v. Tucker*,
221 Fed. 305, 137 C.C.A. 255 C.C.A. 2 ..... 18

*Bradley v. Fina (In re Fina)*,
550 Fed. Appx. 150 (4th Cir. 2014) ..... 14, 22

*Bruce v. Fazilat, (In re Bruce)*,
2018 WL 3424581 (Bankr. N.D. Cal.
July 12, 2018) ..... 9, 15, 16

*Burlingham v. Crouse*,
228 U.S. 459 (1913) ..... 4

*Donovan v. Mazzola*,
716 F.2d 1226 (9th Cir. 1983) ..... 20, 21

*FTC v. Leshin*,
618 F.3d 1221 (11th Cir. 2010) ..... 20

*Green Point Credit, LLC v. McLean (In re McLean)*,
794 F.3d 1313 (11th Cir. 2015) ..... 4, 5

*Hardy v. United States ex rel. Internal
Revenue Service (In re Hardy)*,
97 F.3d 1384 (11th Cir. 1996) ..... 5, 14, 22

*Hodgson v. A-1 Ambulance Serv., Inc.*,
455 F.2d 372 (8th Cir. 1972) .....20

*In re Cano*,
410 B.R. 506 (Bankr. S.D. Tex. 2009).....6

*In re Crystal Palace Gambling Hall, Inc.*,
817 F.2d 1361 (9th Cir. 1987) .....21

*In re Lang*,
398 B.R. 1 (Bankr. N.D. Iowa 2008) .....7

*In re McClure*,
420 B.R. 655 (Bank. N.D. Tex. 2009).....7

*In re Pratt*,
462 F.3d 14 (1st Cir. 2006).....14, 22

*In re Shaw*,
2017 WL 2791663 (B.A.P. 9th Cir.
June 27, 2017) .....*passim*

*In re Tardo*,
145 B.R. 862 (E.D. La. 1992).....8

*Lines v. Frederick*,
400 U.S. 18 (1921) .....4

*Local Loan Co. v. Hunt*,
292 U.S. 234 (1914) .....4

*Lorenzen v. Taggart (In re Taggart)*,
888 F.3d 438 (9th Cir. 2018) .....*passim*

*Martin v. Trinity Indus., Inc.*,
959 F.2d 45 (5th Cir. 1992) ..... 20

*McComb v. Jacksonville Paper Co.*,
336 U.S. 187 (1949) ..... *passim*

*McComb v. Norris*,
177 F.2d 357 (4th Cir. 1949) ..... 19

*Morning Star Company v. Benech (In re Benech)*,
17-CV-05100-LHK (N.D. Cal.,
July 25, 2018) ..... 10, 15, 16

*NLRB v. Fairview Hosp.*,
443 F.2d 1217 (7th Cir. 1971) ..... 20

*NLRB v. Trailways, Inc.*,
729 F.2d 1013 (5th Cir. 1984) ..... 19

*Oil, Chem. & Atomic Workers Int'l Union v. NLRB*,
547 F.2d 575 (D.C. Cir. 1976) ..... 20

*Parker v. Nelson (In re Nelson)*,
2016 WL 7321196 (B.A.P. 9th Cir.
Dec. 15, 2016) ..... 12, 14, 15, 16

*Proudfit Loose Leaf Co. v. Kalamazoo Loose Leaf Binder Co.*, 230 F. 120
(6th Cir. 1915) ..... 17

*Screw Mach. Tool Co. v. Slater Tool & Eng'g Corp.*,
480 F.2d 1042 (6th Cir. 1973) ..... 19

*Star Fin. Servs. v. Aastar Mortg. Corp.*,
89 F.3d 5 (1st Cir. 1996) ..... 19

*Sterling v. Southlake Nautilus Health & Racquet Club, Inc.*, 2018 WL 3660058 (N.D. Ind. Aug. 2, 2018) ..... 7

*Vuitton et Fils S.A. v. Carousel Handbags*, 592 F.2d 126 (2d Cir. 1979) ..... 19

*Waste Conversion, Inc. v. Rollins Envtl. Servs. (NJ), Inc.*, 893 F.2d 605 (3d Cir. 1990) ..... 19

**STATUTES:**

11 U.S.C. § 105(a) ..... 6
11 U.S.C. § 523 ..... 4, 12
11 U.S.C. § 524 ..... 4, 5, 6
11 U.S.C. § 524(a) ..... 4
11 U.S.C. § 524(a)(2) ..... 6, 15, 17
11 U.S.C. § 524(c) ..... 16
11 U.S.C. § 727(a), (c) ..... 12
11 U.S.C. § 727 ..... 4, 5
11 U.S.C. § 1328 ..... 5
29 U.S.C.S. § 201 ..... 18

**OTHER AUTHORITIES:**

4 COLLIER ON BANKRUPTCY ¶ 524.LH(1) (Richard Levin and Henry J. Sommer eds., 16th ed.) ..... 5, 8

Marianne B. Culhane and Michaela M. White, Debt After Discharge: An Empirical Study of Reaffirmation, 73 Am. Bankr. L.J. 709 (1999) ..... 7

H.R. Rep. No. 2, at 365-66 (1977) ..... 5

Official Bankruptcy Form 318 ..... 6

## INTEREST OF AMICUS CURIAE[1]

The National Consumer Bankruptcy Rights Center (NCBRC) is a nonprofit organization dedicated to preserving the bankruptcy rights of consumer debtors and protecting the bankruptcy system's integrity. The Bankruptcy Code grants financially distressed debtors certain rights that are critical to the bankruptcy system's operation. Yet consumer debtors with limited financial resources and minimal exposure to that system are often ill-equipped to protect their rights in the appellate process. NCBRC files amicus curiae briefs in systemically-important cases to ensure that courts have a full understanding of the applicable bankruptcy law, the case, and its implications for consumer debtors.

The National Association of Consumer Bankruptcy Attorneys (NACBA) is a nonprofit organization of over 2000 consumer bankruptcy attorneys nationwide. NACBA has members practicing in all 50 states as well as Puerto Rico and the District of Colombia. As such NACBA and its members have a special interest in the uniformity of bankruptcy practice across the United States.

NCBRC, NACBA and its membership have a vital interest in the outcome of this case. Most debtors find it hard to afford bankruptcy, let alone

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[1] No counsel for a party authored this brief in whole or in part, and no person or entity other than NCBRC, NACBA, its members, and its counsel made any monetary contribution toward the preparation or submission of this brief Both Petitioner and Respondent have consented to the filing of this brief, and letters of consent accompany the brief

defend against the collection of discharged debts after bankruptcy. To avoid liability creditors have advanced a myriad of theories to justify post-discharge collection attempts. But efforts to collect on discharged debts strike at the heart of our bankruptcy laws and the fresh start those laws were designed to provide.

## SUMMARY OF ARGUMENT

To effectuate bankruptcy's foundational fresh start principle, creditors need to understand and abide by the extensive scope of the Bankruptcy Code's discharge and discharge injunction. Creditors who attempt to collect on discharged debt should be held accountable for their conduct. Assessing whether creditors' conduct is subject to sanctions is best determined with a straightforward test that is focused on creditors' conduct, that is consistent with decades of civil contempt jurisprudence, and that does not take into account the creditors' subjective intent (or good faith). The majority of circuits use such a test. Simply put, the appropriate standard asks only whether the creditor: 1) had notice of the bankruptcy discharge, and 2) intended the conduct that violated the discharge injunction. The test contains no good faith exception.

In the decision below, the Ninth Circuit Court Appeals departed from well-established jurisprudence by injecting into the discharge violation analysis a determination of the creditor's subjective good faith belief, even if unreasonable. *Lorenzen v. Taggart* (*In re Taggart*), 888 F.3d 438 (9th Cir. 2018). The *Taggart* standard imposes significant costs on the bankruptcy system and on debtors, it undermines the efficacy of the bankruptcy

discharge, it chills debtors' efforts to protect their fresh start, and it rewards ignorance of the law. Because the *Taggart* analysis is a fact-based inquiry that implicates a party's subjective belief, even an unreasonable one, an evidentiary hearing is now required in every discharge violation case. For courts this means more time devoted to evidentiary hearings than would be necessary using an objective test. For debtors this means spending thousands, if not tens of thousands of dollars, protecting their discharge. Even assuming debtors have the financial ability to defend their discharge, the evidentiary burden to prove the creditor's lack of good faith by clear and convincing evidence is practically insurmountable.

Under *Taggart*, knowledge of bankruptcy law is discouraged. Lower courts applying the *Taggart* standard have excused obvious, and at times egregious, discharge violations because the creditor professed lack of knowledge with respect to the scope of the discharge or the discharge injunction. The *Taggart* framework encourages creditors to aggressively collect on discharged debt knowing sanctions can be avoided by claiming lack of knowledge or good faith.

This Court should reject *Taggart*'s good faith exception when analyzing discharge violations and should adopt the objective test used by the vast majority of courts. Under the objective test if the creditor has notice of the bankruptcy discharge and intends its conduct to collect discharged debt, the creditor is subject to sanction. Such a test is consistent with Congressional intent in creating the modern discharge injunction. It is also consistent with the standard for civil contempt outside of the

bankruptcy discharge context as set forth in *McComb v. Jacksonville Paper Co.*, 336 U.S. 187, 191 (1949), and subsequent decisions in every circuit court of appeals, including the Ninth Circuit. Importantly, an objective test focused on the creditor's conduct preserves and protects the discharge that is the foundation of bankruptcy law.

## STATUTORY FRAMEWORK

Bankruptcy law reflects a balancing act in which Congress has established the rules for adjusting debtor-creditor relationships. The two main purposes of bankruptcy are to provide a fresh start to the debtor and to facilitate the fair and orderly repayment of creditors to the extent possible. *See Burlingham v. Crouse*, 228 U.S. 459, 473 (1913).

One of the primary purposes of federal bankruptcy law is to "give the debtor a 'new opportunity in life and a clear field for future effort unhampered by the pressure and discouragement of pre-existing debt.'" *Lines v. Frederick*, 400 U.S. 18, 19 (1921) (quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 244-45 (1914). The discharge granted to the debtor and the discharge injunction imposed by 11 U.S.C. § 524(a) serve this purpose by first discharging the debtor from liability for most prepetition claims and second prohibiting "the commencement or continuation of an action, the employment of process, or an act, to collect, recover, or offset any [prepetition] debt as a personal liability of the debtor." *Green Point Credit, LLC v. McLean (In re McLean)*, 794 F.3d 1313, 1320 (11th Cir. 2015); *see* 11 U.S.C. §§ 523, 524, 727.

Legislative history demonstrates that the purpose of the modern discharge injunction is to

"eliminate any doubt concerning the effect of the discharge as a total prohibition on debt collection efforts." H.R. Rep. No. 2, at 365-66 (1977). The Bankruptcy Code's current statutory injunction is found in section 524. 11 U.S.C. § 524. This section is derived from section 14f of the former Bankruptcy Act. 4 COLLIER ON BANKRUPTCY ¶ 524.LH(1) (Richard Levin and Henry J. Sommer eds., 16th ed.). Prior to the enactment of section 14f, the "effect of the discharge was to create an affirmative defense that the debtor could plead in any action brought on the discharged debt." *Id.* The purpose of section 14f, as reflected in both the House Judiciary Committee Report and Senate Judiciary Committee Report, was to "effectuate, more fully, the discharge in bankruptcy by rendering it less subject to abuse by harassing creditors." *Id.*

To achieve the Bankruptcy Code's overall "fresh start" aim, the discharge injunction is viewed expansively and accounts for the myriad ways in which prepetition creditors might coerce debtors to pay an otherwise discharged debt. *Hardy v. United States ex rel. Internal Revenue Service (In re Hardy)*, 97 F.3d 1384, 1388-89 (11th Cir. 1996). In effect, the onus is on creditors to terminate all efforts to collect the discharged debt personally from the debtor. *See McLean*, 794 F.3d at 1321.

In practice, if the debtor satisfies the conditions of the Bankruptcy Code, the court grants the debtor a discharge, which relieves the debtor of personal liability for any discharged debt. *See* 11 U.S.C. §§ 727, 1328. The discharge order is a basic declaratory order, stating in its entirety, "IT IS ORDERED: A discharge under 11 U.S.C. . . . is granted to," followed by the name of the debtor, the

date, and the judge's signature. This simple discharge order is uniform across the country and is provided for in the mandatory, official forms. *See, e.g.*, Official Bankruptcy Form 318. The order explains that: "This order means that no one may make any attempt to collect a discharged debt from the debtors personally." *Id.*

Section 524 of the Bankruptcy Code further specifies the effects of that federal order. Section 524(a)(2) provides that: "A discharge in a case under this title . . . operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor, whether or not discharge of such debt is waived." Thus, section 524 provides for injunctive relief to enforce the federal bankruptcy discharge.

Section 524 does not specify a remedy for a violation of the discharge injunction. However, the general consensus of bankruptcy and circuit courts around the country is that discharge violations may be remedied under section 105(a), which allows courts to issue any order necessary or appropriate to carry out the provisions of the Code. *See Bessette v. Avco Fin. Servs.*, 230 F.3d 439, 442 (1st Cir. 2000); *In re Cano*, 410 B.R. 506, 537-541 (Bankr. S.D. Tex. 2009).

## ARGUMENT

### I. *TAGGART* CREATES A BROAD EXCEPTION TO THE DISCHARGE INJUNCTION THAT RENDERS IT VIRTUALLY MEANINGLESS.

The decision below holds that a creditor does not violate the discharge injunction if the creditor had a good faith belief, even if unreasonable, that

the injunction does not apply to its claim. *Lorenzen v. Taggart (In re Taggart)*, 888 F.3d 438, 444 (9th Cir. 2018). Under *Taggart*, to establish a discharge violation, the debtor must show by clear and convincing evidence that the creditor was aware of the discharge injunction and aware that it applied to the creditor's claim. But, whether the party is aware that the discharge injunction is applicable to its claim is a fact-based inquiry which implicates the party's subjective belief, even an unreasonable one. The *Taggart* test thus turns on the subjective motivation and not the objective conduct of the creditor. A creditor's subjective intent may provide a complete defense to a discharge violation. *See Taggart*, 888 F.3d at 444.

Creditors have a myriad of theories, which are, at best, "superficially rationalized schemes intended and actually work to extort payment of a discharged debt." *In re Lang*, 398 B.R. 1, 4 (Bankr. N.D. Iowa 2008). For example, there is a long history of creditors seeking to collect on discharged debts through improper reaffirmation agreements. Marianne B. Culhane and Michaela M. White, *Debt After Discharge: An Empirical Study of Reaffirmation*, 73 Am. Bankr. L.J. 709, 717 (1999) (discussing "rogue" reaffirmation agreements). Creditors have attempted to shield themselves from liability by referring debtors' discharged accounts to collection agents, *see In re McClure*, 420 B.R. 655 (Bank. N.D. Tex. 2009), or have refused to withdraw pending litigation to collect a debt resulting in debtor's post-discharge incarceration. *See Sterling v. Southlake Nautilus Health & Racquet Club, Inc.*, 2018 WL 3660058 (N.D. Ind. Aug. 2, 2018). And, sometimes creditors employ creative legal theories in

an attempt to circumvent the prohibition on collecting discharged debt. *See, e.g., In re Shaw*, 2017 WL 2791663 (B.A.P. 9th Cir. June 27, 2017) (attempting to use "successor liability" theory to collect a discharged debt); *In re Tardo*, 145 B.R. 862 (E.D. La. 1992) (creditor's attorney attempting to collect attorney fees from the debtor that he would have received under contingent fee agreement with creditor arguing that the fee represented a separate debt that had not been scheduled by the debtor and therefore was not discharged).

Under *Taggart*, creditors now have a free pass to ignore the discharge injunction, engage in collection activity on discharged debt, and force debtors to later disprove the creditors' good faith. Given that creditors can assert their subjective intent as a complete defense to a discharge violation, articulation of any scheme or belief allows creditors to proceed without risk of sanctions. Rather than subjecting debtors to less abuse by harassing creditors, as Congress intended, in the Ninth Circuit the Bankruptcy Code's discharge order and statutory discharge injunction have become practically meaningless. *See* 4 COLLIER ON BANKRUPTCY ¶ 524.LH(1).

## II. BASED ON THE *TAGGART* STANDARD, COURTS IN THE NINTH CIRCUIT HAVE CONSISTENTLY ABSOLVED CREDITORS OF LIABILITY FOR DISCHARGE VIOLATIONS BASED ON THEIR SELF-PROCLAIMED "GOOD FAITH."

In *Taggart*, the court held that as a matter of law that creditor's subjective belief that the discharge did not apply to its claim was sufficient to

absolve it of liability for violation of the discharge injunction. Ninth Circuit courts have hewed closely to that mandate, consistently denying sanctions, where creditors raised their subjective intent as a defense to liability. Four examples stand out.

In *Bruce v. Fazilat, (In re Bruce)*, 2018 WL 3424581 (Bankr. N.D. Cal. July 12, 2018), the bankruptcy court refused to order sanctions despite finding a discharge injunction violation because of creditor counsel's mistake of law. *Id.* at *5. In *Bruce* the creditor sought to evict the debtor from rental housing by bringing an unlawful detainer action. *Id.* at *1-2. Before the case came to trial the debtor filed for Chapter 7 bankruptcy. The creditor was listed on the schedules. While the bankruptcy was pending, the creditor cut the lock off of the electrical box, turned the power off and put a new lock on the box. Shortly thereafter, the creditor tried to break into the house to collect the money owed. Then the creditor's daughter contacted the debtor's employer, purportedly to ask for the debtor's address so he could be sued. Within a week of the contact the debtor was told to resign his employment or be fired. He resigned.

After the discharge, the unlawful detainer trial was held in state court, and the creditor obtained a personal judgment against the debtor for over $13,000.00 for rent and costs. *Id.* at *3. Later, the bankruptcy court found that the state court judgment imposed personal liability on the debtor for a lease that had been rejected in the bankruptcy, and therefore discharged. The state court judgment was declared to be void.

The court declined, however, to award sanctions against the creditor for obtaining a personal judgment against the debtor on a discharged debt. Citing to *Taggart's* unreasonable good faith belief standard, the court accepted the creditor attorney's defense that he believed he had a right to sue for damages and attorney fees, despite the bankruptcy discharge. "Here, there is no doubt that [creditor's attorney] had a good faith belief that he was properly bringing an action in the state court for holdover damages and attorney's fees." *Id.* at *5. The court vacated the state court judgment but found no contempt. The debtor was left to bear the costs of removing the judgment obtained in violation of the discharge injunction.

In *Morning Star Company v. Benech (In re Benech)*, 17-CV-05100-LHK (N.D. Cal., Order Vacating Order of Bankruptcy Court, July 25, 2018) (Addendum A), the district court reversed a bankruptcy court's contempt finding based on creditor's counsel "mistake of law." In 2009, Benech, the debtor, signed a promissory note secured by a deed of trust on his San Francisco property. In October 2013, Benech filed Chapter 7 bankruptcy and received his discharge in March 2014, which eliminated his personal liability on the note. In 2015, Benech executed an agreement that purportedly reaffirmed his obligation to pay the creditor the full amount of his already discharged promissory note plus interest. The property was subsequently foreclosed, and the creditor sued the debtor in state court for the deficiency between the amount owed on the note and sale proceeds.

Benech's attorney informed the creditor that the underlying debt had been discharged in

bankruptcy and not reaffirmed in the manner required by the Bankruptcy Code. When the creditor continued to pursue the debtor, Benech filed a motion for contempt in the bankruptcy court. At the hearing, counsel for the creditor revealed that he did not understand the basis for the contempt motion. The bankruptcy court explained that the act of trying to collect on the discharged debt violated the discharge absent a proper reaffirmation agreement. The court found the creditor in contempt and awarded Benech $19,247.74 in attorney fees and costs.

On appeal the creditor asserted that Benech did not prove by clear and convincing evidence that the creditor knew the discharge applied to its claim, because creditor's counsel believed there was no violation for entering into an improper postpetition reaffirmation agreement and then enforcing it. The district court agreed and remanded the case to the bankruptcy court for an evidentiary hearing to determine if the creditor knew the discharge applied to its claim, keeping in mind that a good faith belief, even if unreasonable, would insulate the creditor from sanctions.

In *In re Shaw*, 2017 WL 2791663 (B.A.P. 9th Cir. June 27, 2017), the Ninth Circuit Bankruptcy Appellate Panel (BAP) similarly reversed the bankruptcy court because the debtor did not prove that the creditor knew that its postpetition efforts to collect a prepetition debt violated the discharge injunction. In *Shaw* the creditor, Rogerson, sued the debtor Shaw in state court seeking to recover over $350,000 owed on a promissory note. *Id.* at *1. Shortly thereafter, Shaw filed Chapter 7 bankruptcy. Rogerson was listed both as a secured and unsecured

creditor. Rogerson did not object to the debtor's discharge or seek a determination that debts owed to her were nondischargeable. 11 U.S.C. § 523 (listing debts that are nondischargeable); 11 U.S.C. § 727(a), (c) (relating to denials of discharge). Shaw received his bankruptcy discharge, and Rogerson admitted receiving notice of the discharge.

Later, Rogerson amended her state court claim. *Id.* at *2. Her new claim alleged that Shaw remained personally liable on the discharged debt as the successor in interest to an LLC previously formed and then dissolved by Shaw. That is, Rogerson sought to hold Shaw personally liable for the discharged debt in state court under a different theory of liability.

Shaw filed a motion in bankruptcy court to enforce his discharge. *Id.* at 3. The bankruptcy court rejected Rogerson's defenses and found that she had willfully violated the discharge injunction. According to the bankruptcy court, the state court claims were merely an artifice to reimpose individual liability on Shaw for discharged debts. The court awarded Shaw attorney fees and costs of $34,821.00.

The BAP reversed and remanded the case because the bankruptcy court had not conducted an evidentiary hearing. *Id.* at *6. Furthermore, according to the BAP, based on the appellate record Shaw had not proven that Rogerson subjectively knew that the legal theories of recovery she asserted violated the discharge injunction. *Id.*

In *Parker v. Nelson (In re Nelson)*, 2016 WL 7321196 (B.A.P. 9th Cir. Dec. 15, 2016), the BAP reversed the bankruptcy court's order holding the debtor's former attorney, Parker, in contempt for

violating the discharge injunction. Parker represented the debtor with respect to prepetition accident claims. He was terminated from representing the debtor, and he was listed as a creditor on the bankruptcy petition and mailing matrix at the correct address. Nevertheless, Parker continued to assert amounts were owed after the debtor received her discharge. On two occasions the debtor's current attorney sent letters to Parker putting him on notice that the further attempts to collect the debt violated the discharge injunction. Parker never responded to the two letters and debtor's attorney filed a motion for contempt. The motion was granted and the debtor was awarded attorney fees and costs in the amount of $2,049.00. No evidentiary hearing was held.

On appeal the BAP reversed the bankruptcy court order and remanded the case for an evidentiary hearing. A second hearing was held and once again Parker was found in contempt. The bankruptcy court found that Parker had actual knowledge of the discharge injunction in 2013 and still attempted to collect the debt in violation of the discharge injunction for two years thereafter. The bankruptcy court awarded the debtor costs and attorney fees in the amount of $17,887.50.

On appeal for a second time, the BAP once again reversed the bankruptcy court. On review the BAP found that Parker's assertion that he did not know that the discharge injunction applied to his claims provided him a complete defense to contempt under the *Taggart* standard. As the dissent remarked "Parker avoids a finding of contempt simply by testifying (credibly) that he did not subjectively believe that the discharge applied to his

attorney fee claims, no matter how misguided or unreasonable his belief might have been." *Nelson*, 2016 WL 7321196 at *11.

In *Taggart* and each of the cases cited above, the debtor proved that the debtor filed bankruptcy, the creditor's debt was listed in the bankruptcy schedules, the debtor received a discharge, the creditor received notice of the discharge, and that the creditor then continued attempts to collect the discharged debt personally from the debtor. Under the majority approach that proof is sufficient for the court to find the creditor violated the discharge injunction. *See Hardy*, 97 F.3d at 1390; *see also In re Pratt*, 462 F.3d 14, 20-21 (1st Cir. 2006) (creditor's good faith not a defense to discharge violations); *Banco Popular, North America v. Kanning*, 638 Fed. Appx. 328, 342 (5th Cir. 2016) (describing test for evaluating discharge violation and citing *Hardy*); *Bradley v. Fina* (*In re Fina*), 550 Fed. Appx. 150, 145-55 (4th Cir. 2014) (citing *Hardy* and concluding subjective belief or intent not relevant to inquiry). The *Taggart* decision now gives these creditors a free pass.

Further, the Ninth Circuit does not explain how a debtor disproves the creditor's subjective intent. The fact that a debtor notifies the creditor in writing why the discharge injunction applies has not been sufficient. And no amount of objective proof appears to suffice if the creditor asserts a good faith, but unreasonable, belief that its conduct was not prohibited by the discharge injunction.

## III. THE *TAGGART* TEST REWARDS PURPOSEFUL IGNORANCE OF BANKRUPTCY LAW.

In the cases above, the creditor's conduct was purportedly based on a mistaken understanding of bankruptcy law, the discharge, and the discharge injunction.

In *Bruce*, the creditor obtained a judgment against the debtor personally based on a prepetition lease that had been rejected in the bankruptcy and therefore discharged. 2018 WL 424581 (Bankr. N.D. Cal. July 12, 2018). The postpetition judgment that the creditor obtained violated the discharge injunction. However, creditor's counsel credibly testified that he did not know his conduct violated the injunction. The debtor had to bear the cost of resorting to the bankruptcy court to avoid the $16,216.56 judgment obtained against him. In *Nelson*, the creditor, an attorney, claimed he did not know that his debt for prepetition legal services was discharged in bankruptcy. *Nelson*, 2016 WL 7321196 (B.A.P. 9th Cir. Dec. 15, 2016). In *Shaw*, the creditor knew the debt was discharged. 2017 WL 2791663 (B.A.P. 9th Cir. June 27, 2017). However, the creditor claimed that pursuing the debtor under a different theory of liability would justify attempts to collect the discharged debt. The bankruptcy court found that the state court claims were merely an artifice to reimpose individual liability on Shaw for discharged debts in violation of section 524(a)(2). And, in *Benech*, the creditor sued the debtor on an unenforceable reaffirmation agreement. The creditor was absolved of liability because the creditor argued that it did not know the agreement was unenforceable even though the agreement met none

of the requirements for reaffirmation agreements under the Bankruptcy Code. *Benech*, 17-CV-05100-LHK (N.D. Cal., Order Vacating Order of Bankruptcy Court, July 25, 2018) (Addendum A); *see* 11 U.S.C. § 524(c) (providing comprehensive requirements for reaffirmation agreements).

In each of these cases the cost to defend the debtor's bankruptcy discharge was significant. In *Nelson* the debtor incurred over $17,000.00 in attorney fees and costs and litigated two successful motions for contempt only to have the cases reversed based on the creditor's subjective belief that his underlying claim for attorney fees was not discharged in the bankruptcy. 2016 WL 7321196, at *4. In *Shaw* the debtor incurred over $33,000.00 in attorney fees to defend his discharge. 2017 WL 2791663, at *1. In *Bruce* the debtor expended an unknown amount of fees to obtain a bankruptcy court ruling that a $17,000.00 postpetition judgment was void. In *Benech* the debtor incurred over $19,000.00 in attorney fees and costs to defend against a state court suit brought on a discharged debt. *Benech*, 17-CV-05100-LHK (N.D. Cal., Order Vacating Order of Bankruptcy Court, July 25, 2018) (Addendum A).

None of these cases are particularly complicated. Yet, in each case, creditors professed ignorance of the law at significant cost to the debtors. Most debtors do not have the resources to defend such conduct by creditors. This Court in *McComb* expressed it well. Where "the aim is remedial and not punitive", the "burden of any uncertainty" is on "respondents' shoulders". *McComb*, 336 U.S. at 193. Instead, the decision

below shifts the cost of preserving the fresh start to the debtor.

## IV. CREDITORS' STATE OF MIND SHOULD BE IRRELEVANT WHEN DETERMINING COMPLIANCE WITH THE DISCHARGE INJUNCTION.

The discharge injunction is a statutory injunction that arises directly from the text of the Bankruptcy Code. 11 U.S.C. § 524(a)(2). When a court is called upon to enforce the statutory discharge injunction, pursuant to section 105, the standard applied should not be less rigorous than that used in other civil contempt contexts. In the typical civil contempt analysis, every circuit court of appeals, including the Ninth Circuit, has followed the principles established by this Court in *McComb v. Jacksonville Paper Co.*, 336 U.S. 187, 191, 69 S. Ct. 497, 499 (1949). Under the *McComb* standard the state of mind of the contemnor is irrelevant.

As early as 1915, the Sixth Circuit rejected the idea that "good faith" could be a defense to civil contempt. In *Proudfit Loose Leaf Co. v. Kalamazoo Loose Leaf Binder Co.*, the Sixth Circuit upheld civil contempt, remedial sanctions for violation of a previous patent infringement injunction. 230 F. 120, 132 (6th Cir. 1915). On appeal, defendants claimed that they had acted in "good faith" on counsel's advice that a slight change to its product design would prevent infringement on the plaintiff's patent. The Court rejected that defense as to the damages awarded to the plaintiff:

> True, [defendants] were advised by counsel that the removal of the cover flap avoided infringement; but advice of

> counsel and good-faith conduct do not relieve from liability for a civil contempt, although they may affect the extent of the penalty. It is clear that the order, so far as it adjudged compensation to [plaintiff] here, was amply justified. *Board of Trade v. Tucker* (C.C.A. 2) 221 Fed. 305, 307, 137 C.C.A. 255.

Over 30 years later, the same issue came before this Court in *McComb v. Jacksonville Paper Co.*, 336 U.S. 187, 69 S. Ct. 497 (1949). *McComb* involved a decree enjoining Jacksonville Paper from violating the Fair Labor Standards Act, 29 U.S.C.S. § 201 ("FLSA"), in enumerated ways. *Id.* at 189. Subsequently, McComb, the Administrator of the Wage and Hour Division of the U.S. Department of Labor, instituted a contempt proceeding alleging that Jacksonville Paper failed to comply with the minimum wage, overtime, and record keeping provisions of the injunction. *Id.* While the trial court held that Jacksonville Paper engaged in numerous improper practices, it nevertheless held that there was no "willful" violation of any "specific" provision of the injunction. *Id.* at 190. The Fifth Circuit affirmed.

On review, this Court reversed, holding that the "absence of willfulness" is not a defense to civil contempt:

> Since the purpose is remedial, it matters not with what intent the defendant did the prohibited act. The decree was not fashioned so as to grant or withhold its benefits dependent on

> the state of mind of respondents. It laid on them a duty to obey specified provisions of the statute. An act does not cease to be a violation of a law and of a decree merely because it may have been done innocently.

*Id.* at 191.

*McComb* has since been adopted or applied in every circuit court of appeals in a wide variety of civil contempt contexts. *See, e.g., Star Fin. Servs. v. Aastar Mortg. Corp.*, 89 F.3d 5, 10 (1st Cir. 1996) ("good faith," the "absence of willfulness," or "doing an act innocently" does not relieve a party of contempt in the face of a clear order; trademark infringement); *Vuitton et Fils S.A. v. Carousel Handbags*, 592 F.2d 126, 128 (2d Cir. 1979) (because civil contempt is remedial in nature, the fact that the prohibited act was done inadvertently or in good faith does not preclude a citation for civil contempt; sale of counterfeit handbags); *Waste Conversion, Inc.* v. *Rollins Envtl. Servs. (NJ), Inc.*, 893 F.2d 605, 609 (3d Cir. 1990) ("Good faith" is not a defense to civil contempt; "willfulness" distinguishes criminal contempt from civil contempt); *McComb v. Norris*, 177 F.2d 357, 358-60 (4th Cir. 1949) (enforcement of injunction in civil remedial contempt for violation of FLSA does not depend on defendant's state of mind); *NLRB v. Trailways, Inc.*, 729 F.2d 1013, 1016 (5th Cir. 1984) (absence of willfulness is irrelevant in civil contempt; the only issue was actual compliance with this court orders); *Screw Mach. Tool Co. v. Slater Tool & Eng'g Corp.*, 480 F.2d 1042, 1044 (6th Cir. 1973) (in civil, remedial contempt neither the "frequency of the violations" nor the "good intentions of the violator" are material; unfair trade practices);

*NLRB v. Fairview Hosp.*, 443 F.2d 1217, 1220 (7th Cir. 1971) ("good faith" does not justify failing to obey a court order enjoining violations of the NLRA); *Hodgson v. A-1 Ambulance Serv., Inc.*, 455 F.2d 372, 374 (8th Cir. 1972) ("willfulness" or "lack of willfulness" had "nothing to do with the question of civil contempt for noncompliance with the injunction"; FLSA); *Donovan v. Mazzola*, 716 F.2d 1226, 1228 (9th Cir. 1983) (intent is not an issue in civil contempt proceedings; ERISA); *FTC v. Leshin*, 618 F.3d 1221, 1232-33 (11th Cir. 2010) ("The decisions of our Court and our predecessor court have held that substantial, diligent, or good faith efforts are not enough; the only issue is compliance."); *Oil, Chem. & Atomic Workers Int'l Union v. NLRB*, 547 F.2d 575, 581 (D.C. Cir. 1976)("good faith or lack of willfulness" is not a defense to civil contempt; NLRA).

The circuit courts of appeals are in general agreement as to the elements of civil contempt. The Fifth Circuit has the most straightforward recitation of the elements: "A movant in a civil contempt proceeding bears the burden of establishing by clear and convincing evidence (1) that a court order was in effect, (2) that the order required certain conduct by the respondent, and (3) that the respondent failed to comply with the court's order." *Martin v. Trinity Indus., Inc.*, 959 F.2d 45, 47 (5th Cir. 1992).

Even the Ninth Circuit, except in *Taggart*, has adhered to these basic elements of civil contempt in both bankruptcy and non-bankruptcy cases. For example, in *Donovan v. Mazzola*, the Ninth Circuit Court of Appeals upheld a finding of contempt in an ERISA case where the appellants failed to comply with a district court order requiring them to post a

bond by a certain date. 716 F.2d at 1228. The court rejected the appellants' assertions of good faith noting that "[i]ntent is not an issue in civil contempt proceedings." *Id.* at 1240. Similarly, in *In re Crystal Palace Gambling Hall, Inc.*, a chapter 11 bankruptcy case, the Ninth Circuit also applied the *McComb* standard. 817 F.2d 1361 (9th Cir. 1987). There, the chapter 11 debtor failed to timely sell casino assets to a designated purchaser as required by a bankruptcy court order. *Id.* at 1362. In affirming a finding of contempt against the debtor, the court stated that "[i]t does not matter what the intent of the appellants was when they disobeyed the court's order." *Id.* at 1365. The court continued that the "proposed 'good faith' exception to the requirement of obedience to a court order has no basis in law, and we reject the invitation to create such an exception." *Id.*

In *Taggart*, the Ninth Circuit announced a standard for evaluating creditor's conduct relative to the discharge injunction that contradicts decades of civil contempt jurisprudence. Under that standard, a creditor cannot be sanctioned for violating the discharge order or statutory discharge injunction if the creditor had a good faith belief, even if unreasonable, that the discharge was inapplicable to its claim. In the decision below, the Ninth Circuit deviated from well-established civil contempt principles. There is no good faith exception to a violation of the discharge injunction.

## CONCLUSION

The appropriate standard for determining a discharge violation is whether the creditor: 1) had notice of the bankruptcy discharge, and 2) intended the conduct that violated the injunction. *See Hardy*, 97 F.3d at 1390. The proper analysis focuses on the creditors' conduct and contains no good faith exception. *Id.*; *see also In re Pratt*, 462 F.3d 14, 20-21 (1st Cir. 2006) (creditor's good faith not a defense to discharge violations); *Banco Popular, North America v. Kanning*, 638 Fed. Appx. 328, 342 (5th Cir. 2016) (describing test for evaluating discharge violation and citing *Hardy*); *Bradley v. Fina* (*In re Fina*), 550 Fed. Appx. 150, 145-55 (4th Cir. 2014) (citing *Hardy* and concluding subjective belief or intent not relevant to inquiry). Under this standard discharge violations are easy to ascertain and capable of objective proof. It appropriately requires creditors to take responsibility for their own conduct with respect to discharged debt; *Taggart* excuses creditors from that same responsibility.

Amici NCBRC and NACBA respectfully submit that this Court should reverse the decision below and hold that the creditor's subjective intent, or "good faith," is not relevant when evaluating whether a creditor violated the Bankruptcy Code's statutory discharge injunction.

Respectfully submitted,

*/s/ Tara Twomey*

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Dated: February 26, 2019

# ADDENDUM A

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

THE MORNING STAR COMPANY, et al.

Appellants,

v.

ROBERT BENECH,

Appellee.

Case No. 17-CV-05100-LHK

**ORDER VACATING ORDER OF BANKRUPTCY COURT**

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THE MORNING STAR COMPANY, et al.

Appellants,

v.

ROBERT BENECH,

Appellee.

Case No. 17-CV-07108-LHK

**ORDER VACATING ORDER OF BANKRUPTCY COURT**

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Appellants Morning Star Company, Weintraub Tobin Chediak Coleman Grodin Law Corporation, and Chris Rufer ("Appellants") appeal the Bankruptcy Court's order finding Appellants in contempt for violating the discharge injunction of Robert Benech ("Appellee"). *Morning Star Company et al. v. Benech*, Case No. 17-CV-05100-LHK ("*Morning Star I*"). Appellants also appeal the Bankruptcy Court's subsequent order awarding Appellee $19,247.74 in attorney's fees and costs

spent as a result of Appellee's violation of the discharge injunction. *Morning Star Company et al. v. Benech*, Case No. 17-cv-07108-LHK ("*Morning Star II*").[3] Having considered the parties' submissions, the relevant law, and the record in this case, the Court VACATES both orders and REMANDS for reconsideration of the contempt finding.

## I. BACKGROUND

### A. Factual Background

On October 8, 2009, Appellee executed a promissory note secured by a Deed of Trust in favor of Appellant Chris Rufer ("Rufer") in the amount of $310,000 ("the Promissory Note"). *Morning Star I*, ECF No. 10 (Appellant's Amended Excerpts of Record, or "ER") at 154. To secure Appellee's obligations under the Promissory Note, a Deed of Trust was recorded against Appellee's property in San Francisco, California. *Id.* On December 31, 2010, Rufer assigned his rights and obligations under the Promissory Note and Deed of Trust to Appellant Morning Star Company ("Morning Star"). *Id.* at 155.

On April 17, 2012, Appellee entered into a Severance and Release Agreement ("Severance Agreement") with VSP Products, Inc. ("VSP") which is owned by Rufer. *Id.* at 155. Prior to the Severance Agreement, Appellee was an employee of VSP. *Id.* The Severance Agreement amended the principal owed by Appellee under the Promissory Note to $250,000. *Id.*

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[3] The Court granted the parties' stipulation to consolidate the two appeals *Morning Star I*, ECF No. 17; *Morning Star II*, ECF No. 5.

On December 20, 2013, Appellee filed for Chapter 7 bankruptcy, listing a $250,000 secured debt to Rufer. *Id.* at 129. On March 28, 2014, Appellee received his discharge. *Id.* at 170. Appellants do not dispute that this discharged the $250,000 Appellee owed under the Promissory Note. The bankruptcy case closed on August 15, 2014. *Id.* at 114.

On April 1, 2016, Appellee and Morning Star entered into a Promissory Note Payoff and Standstill Agreement ("Standstill Agreement"). *Id.* at 135–39 (text of the Standstill Agreement).

The Standstill Agreement obligated Appellee to pay Morning Star the entire balance of the already-discharged Promissory Note plus interest, which amounted to $345,334.59 plus an additional $51.37 of interest each day. *Id.* at 135–36. For its part, Morning Star agreed to delay its foreclosure of Appellee's San Francisco property until June 1, 2016. *Id.* at 136. The Standstill Agreement makes no mention of the bankruptcy proceedings. Appellee and Morning Star were both represented by counsel, but Appellee has since sued his former attorneys for malpractice. *Id.* at 92–95 (complaint in malpractice suit).

Appellee's sale of his San Francisco property resulted in a payment of $126,965.94 to Morning Star. *Id.* at 156. On February 15, 2017, Morning Star filed a complaint against Appellee in Superior Court for the County of Yolo that sought to enforce payment of the Promissory Note that had been discharged in bankruptcy. *Id.* at 153–58 (copy of complaint). On March 20, 2017, Appellee informed Morning Star through his current counsel that the

Promissory Note had been discharged in bankruptcy and asked Morning Star to dismiss the state court action. *Id.* at 145. Morning Star refused. *Id.* at 146–49. Instead, Morning Star filed an amended complaint that alleged Appellee had breached the Standstill Agreement instead of the Promissory Note and alleged that the Standstill Agreement was supported by separate consideration. *Id.* at 172–79.

**B. Procedural History**

On May 2, 2017, Appellee filed a motion to reopen his bankruptcy case in order to file a motion for damages against Morning Star for violating the discharge injunction. *Id.* at 103–04. On May 20, 2017, the Bankruptcy Court denied this motion on the grounds that the motion was unnecessary in order to bring a contempt motion. *Id.* at 104.

On June 29, 2017, Appellee filed a motion for contempt. *Id.* at 113–122 (copy of motion). On August 17, 2017, the Bankruptcy Court granted Appellee's motion and found Appellants in contempt. *Id.* at 1–3. The Bankruptcy Court, subject to further proof, awarded Appellee attorney's fees and costs incurred as a result of Appellants' violation of the discharge injunction and emotional distress damages. *Id.* at 2. The Bankruptcy Court denied an award of punitive damages. *Id.* On September 1, 2017, Appellants appealed the Bankruptcy Court's order finding Appellants in contempt. *Morning Star I*, ECF No. 1 (notice of appeal).

On December 5, 2017, the Bankruptcy Court awarded Appellee $19,247.74 in attorney's fees and costs. *Morning Star II*, ECF No. 1-2. On December 14, 2017, Appellants appealed the Bankruptcy Court's order awarding attorney's fees and costs.

*Morning Star II*, ECF No 1 (notice of appeal). On March 28, 2018, the Court granted the parties' stipulation to consolidate the two appeals. *Morning Star I*, ECF No. 17; *Morning Star II*, ECF No. 5.

On November 29, 2017, Appellants filed their opening brief. *Morning Star I*, ECF No. 8 ("Appellant Br."). On January 3, 2018, Appellee filed his response brief. *Morning Star I*, ECF No. 14 ("Appellee Br."). On January 17, 2018, Appellants filed their reply. *Morning Star I*, ECF No. 16 ("Reply Br.").

## II. LEGAL STANDARD

A federal district court has jurisdiction to entertain an appeal from a bankruptcy court under 28 U.S.C. § 158(a), which provides: "The district courts of the United States shall have jurisdiction to hear appeals ... from final judgments, orders, and decrees[ ] of bankruptcy judges[.]" On appeal, a district court reviews a bankruptcy court's conclusions of law de novo, and the bankruptcy court's factual findings for clear error. *In re Greene*, 583 F.3d 614, 618 (9th Cir. 2009) (citing *In re Raintree Healthcare Corp.*, 431 F.3d 685, 687 (9th Cir. 2005)); *In re Salazar*, 430 F.3d 992, 994 (9th Cir. 2005); *see In re Taggart*, 548 B.R. 275, 286 (B.A.P. 9th Cir. 2016), *aff'd*, 888 F.3d 438 (9th Cir. 2018) ("*Taggart I*"). A bankruptcy court's "decision to impose contempt sanctions is reviewed for an abuse of discretion." *In re Taggart*, 888 F.3d 438, 443 (9th Cir. 2018) ("*Taggart II*").

## III. DISCUSSION

The Bankruptcy Court found Appellants in contempt and awarded Appellee attorney's fees and

costs because the Bankruptcy Court found that Appellants had willfully violated the discharge injunction. Appellants argue that the Bankruptcy Court erred in finding them in contempt because they did not, in fact, violate the discharge injunction. Appellants argue in the alternative that even if they violated the discharge injunction the Bankruptcy Court misapplied the legal standard for a finding of contempt and should have conducted an evidentiary hearing. The Court rejects Appellants' initial argument, but agrees that the Bankruptcy Court misapplied the legal standard and should have conducted an evidentiary hearing.

**A. Violation of the Discharge Agreement**

Appellants' post-discharge contract with Appellee ("Standstill Agreement") revived debts Appellee had already discharged in bankruptcy. Appellants argue the Standstill Agreement could permissibly do this for three reasons. First, Appellants argue that the Standstill Agreement was valid because it was based on consideration separate from the debts Appellee discharged in bankruptcy. Second, Appellants argue that Appellee judicially admitted the Standstill Agreement is valid and therefore can no longer contend that the Standstill Agreement is not valid. Third, Appellants argue that Appellee forfeited any reliance on the discharge injunction because he voluntarily sought out and entered into the Standstill Agreement. None of these arguments are persuasive.

Appellants' first argument relies on distinguishing the Standstill Agreement from a reaffirmation agreement. Reaffirmation agreements are agreements "based at least 'in part' on the

discharged debt" and which therefore must comply with the requirements of 11 U.S.C. § 524(c). *In re Lopez*, 345 F.3d 701, 707 (9th Cir. 2003) (quoting § 524(c)); *see also Bobka v. Toyota Motor Credit Corp.*, 2018 WL 2382766, at *4 (S.D. Cal. May 24, 2018) (noting reaffirmation agreements "are contrary to the stated goal of a debtor receiving a fresh start" and are therefore "subject to intense judicial scrutiny and must comply with all statutory requirements" (citation omitted)). The Bankruptcy Court found that the Standstill Agreement did not comply with § 524(c)'s requirements, a finding Appellants do not dispute here. ER at 12 ("[T]o be a valid agreement it ... must ... satisfy the requirements of 524 (c). There are five requirements. None of them are satisfied and they couldn't be because it has to be entered into pre- prior to discharge.").

To avoid the Bankruptcy Court's finding, Appellants contend that the Standstill Agreement is not a reaffirmation agreement but is instead a valid post-petition agreement. Appellants suggest contracts (such as the Standstill Agreement) constitute valid post-petition agreements provided that there is "some new separate consideration for the subsequent agreement." Appellant Br. at 10. Appellants argue that they provided new consideration by agreeing to wait two months before foreclosing on Appellee's property, and that Appellee provided new consideration by agreeing to waive his claims against Chris Rufer, Morning Star, Tim Cruise and Nick Kastle. *Id.* at 10. Appellants point to *In re Heirholzer*, which found that a post-discharge contract was not a reaffirmation agreement because the creditor's "decision to forego

foreclosure represents new and sufficient consideration to support a binding post-discharge obligation." 170 B.R. 938, 941 (Bankr. N.D. Ohio 1994). Appellants also cite *In re Martin*, which found that "post-petition agreements can create an enforceable obligation." 474 B.R. 789, at *7 (B.A.P. 6th Cir. 2012).

Appellants' argument is not credible. By its terms, § 524(c) applies to "[a]n agreement between a holder of a claim and the debtor, the consideration for which, in whole *or in part*, is based on a debt that is dischargeable ... ." 11 U.S.C. § 524(c) (emphasis added). The Standstill Agreement reaffirms Appellee's debts to Appellants under an already-discharged promissory note, which is precisely why Appellants filed a lawsuit in state court to collect the balance due under the discharged promissory note. *Id.* at 153–58 (copy of state court complaint seeking to collect on discharged promissory note); Appellant Br. at 5 ("On February 15, 2017, Morning Star filed a verified complaint in Yolo County Superior Court seeking payment of the balance due."). Thus even assuming *arguendo* that Appellants' delay and Appellee's waiver were valid consideration, the Standstill Agreement would remain at least "in part" based on Appellee's reaffirmation of hundreds of thousands of dollars of previously discharged debt. Appellant Br. at 4 (noting that as part of the Standstill Agreement Appellee agreed that he still owed $345,334.59 plus interest under a note discharged in bankruptcy).

*Heirholzer* and *Martin* do not compel a different conclusion. To start, both decisions are out-of-circuit bankruptcy decisions which means they are not binding here. Moreover, *Heirholzer* was

premised on a finding that the post-discharge agreement was "completely separate from the initial note that was discharged in bankruptcy." 170 B.R. at 941. By contrast, the Standstill Agreement reaffirms debts owed under a promissory note that was discharged in bankruptcy. *See also In re Getzoff*, 180 B.R. 572, 575 (B.A.P. 9th Cir. 1995) (rejecting argument that, in light of *Heirholzer*, a post-petition agreement in which creditor traded an extension of a loan for debtor's promise to honor discharged debt was valid).

Furthermore, *Martin*'s statement that "post-petition agreements can create an enforceable obligation" referred to "debt that arises *after* the creditor files for bankruptcy relief ... ." 474 B.R. 789, at *7 (emphasis added). That holding is inapplicable here because Appellee's debt arose before bankruptcy. Furthermore, *Martin* affirmed a bankruptcy court's finding that a creditor was in contempt for violating the discharge injunction where the creditor sought to enforce a post-discharge agreement and relied on the same theory Appellants pursue here. *Id.* at *10 (affirming sanctions despite creditor's mistaken belief that post-petition agreement with debtor was valid because "debtor had voluntarily agreed to enter into a new contract with him"). The bottom line is that the Standstill Agreement is a reaffirmation agreement that did not comply with § 524(c)'s requirements. Thus, Appellants violated the discharge injunction.

Appellants' second argument is that Appellee has judicially admitted that the Standstill Agreement is valid and cannot now argue otherwise. Appellants' argument rests on Appellee's complaint in his malpractice suit against the attorneys who

advised him in connection with the Standstill Agreement. The complaint alleges that Appellee's erstwhile attorneys "should have advised Plaintiff that entering into the ... [Standstill] Agreement would be considered new consideration and that Plaintiff's obligations under the ... [Standstill] Agreement would therefore not be included in the discharge Plaintiff received in his bankruptcy case." Appellant Br. at 17. Appellants' theory is unpersuasive because the complaint's statement is not a judicial admission. "Judicial admissions apply only to factual statements, not statements of law." *Maloney v. Scottsdale Ins. Co.*, 256 F. App'x 29, 32 n.3 (9th Cir. 2007). A conclusion about the legal effect of a contract or a bankruptcy discharge is a statement of law, not a statement of fact.[4] Even assuming *arguendo* that some legal conclusions are binding, this statement is not one of them. The complaint is describing how the Standstill Agreement "would be considered" by others, not what the Standstill Agreement's actual legal effect is or how Appellee himself understands it. Thus, the statement does not bind Appellee to any particular view as to the Standstill Agreement's validity or invalidity.

Appellants' third argument is that Appellee cannot rely on the discharge injunction's protection because he voluntarily signed the Standstill Agreement after the discharge. Appellants rely on a

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[4] More generally, it is a stretch for Appellants to rest their argument that the Standstill Agreement is valid on a lawsuit alleging Appellee's former lawyers committed malpractice by advising him to sign it.

strained reading of *In re Ybarra*, 424 F.3d 1018 (9th Cir. 2005), and *Siegel v. Federal Home Loan Mortgage Corp.*, 143 F.3d 525 (9th Cir. 1998). Appellants claim these cases show that a debtor cannot use a discharge injunction as a shield against contractual liability after "affirmatively seeking and obtaining the new" agreement following discharge from bankruptcy proceedings. Appellant Br. at 12.

Appellants read *Ybarra* and *Siegel* far too broadly because both decisions were concerned with the narrow issue of attorney's fees. *Siegel* "held that an award of attorney fees incurred post-petition based on a pre-petition cause of action was not discharged in bankruptcy." *Ybarra*, 424 F.3d at 1021. *Ybarra* simply "reaffirm[ed] that claims for attorney fees and costs incurred post-petition are not discharged where post-petition, the debtor voluntarily commences litigation or otherwise voluntarily 'return[s] to the fray.'" *Id.* at 1026 (quoting *Siegel*, 143 F.3d at 533–34) (second alteration in original). Neither decision states or implies that a contract reaffirming a discharged debt is somehow exempt from the discharge injunction. Moreover, even if *Ybarra* and *Siegel* could be read as Appellants suggest—and they cannot—Appellants fail to explain how this new exemption to the discharge injunction would excuse the Standstill Agreement's noncompliance with § 524(c)'s requirements for debts "based at least 'in part' on the discharged debt[s]." *Lopez*, 345 F.3d at 707.

In sum, the Court finds that the Standstill Agreement was barred by the discharge injunction. The Court now turns to whether the Bankruptcy Court's orders finding Appellants in contempt for attempting to enforce the Standstill Agreement and

awarding Appellee attorney's fees and costs were permissible.

**B. Contempt Finding**

A discharge under Chapter 7 of the bankruptcy code "discharges the debtor from all debts that arose before the date of the" bankruptcy petition. 11 U.S.C. § 727(b). Once issued, the discharge "operates as an injunction against the commencement or continuation of an action ... to collect, recover or offset any such debt as a personal liability of the debtor." 11 U.S.C. § 524(a)(2). A party who violates the discharge injunction can be held in contempt. *In re Zilog, Inc.*, 450 F.3d 996, 1007 (9th Cir. 2006). The party seeking contempt sanctions "must prove that the creditor (1) knew the discharge injunction was applicable and (2) intended the actions which violated the injunction." *Taggart II*, 888 F.3d at 443 (quoting *In re Bennett*, 298 F.3d 1059, 1069 (9th Cir. 2002)).

The requirement that the contemnor "(2) intended the actions which violated the injunction" is not at issue. *Taggart II*, 888 F.3d at 443.The Bankruptcy Court found that the action which violated the discharge injunction was filing the state court complaint to collect on the Standstill Agreement:

MS. OELSNER: No, I understand. No, no. I understand what you're saying and I – I have been doing this for 30 years, so I appreciate the argument you're making. But the entering into the second Standstill Agreement—

THE COURT: But that wasn't what violated the discharge. It was only when you sought to collect.

MS. OELSNER: By filing the complaint.

THE COURT: Right.

ER at 13. Appellants do not dispute that they intended to file the state court complaint. Thus, the second requirement is met because "[t]he focus is on whether the offending party's conduct violated the injunction and whether that conduct was intentional; it does not require a specific intent to violate the injunction." *In re Shaw*, 2017 WL 2791663, at *5 (B.A.P. 9th Cir. June 27, 2017); *see, e.g., In re Meints*, 2017 WL 5973319, at *7 (C.D. Cal. Jan. 4, 2017) (finding attorney's filing of a complaint warranted contempt sanctions where attorney knew of discharge injunction and intended to file complaint).

The parties' dispute instead centers on whether Appellants "(1) knew the discharge injunction was applicable" to the debts the Standstill Agreement purported to revive. *Taggart II*, 888 F.3d at 443. "This standard requires evidence showing the alleged contemnor was aware of the discharge injunction *and* aware that it applied to his or her claim." *Taggart I*, 548 B.R. at 288 (emphasis in original). If a creditor disputes that they had this knowledge, "a finding that they knew of the injunction, and thus willfully violated it, can only be made after an evidentiary hearing." *Zilog*, 450 F.3d at 1008. A creditor's "good faith belief that the discharge injunction does not apply to the creditor's claim precludes a finding of contempt, even if the

creditor's belief is unreasonable." *Taggart II*, 888 F.3d at 444.

Appellants argue that the Bankruptcy Court erred because it did not find that Appellants were aware that the discharge injunction applied to their attempt to enforce the Standstill Agreement. The Bankruptcy Court found Appellants willfully violated the discharge injunction because "as I read the pleadings, there is nothing to indicate that the respondents Morning Star and others didn't understand that this was a discharged debt." ER at 12–13 (hearing transcript). This is in one sense correct: Appellants do not meaningfully dispute that they knew the debt subject to the Standstill Agreement was discharged. However, that is only half of the inquiry because the "alleged contemnor ... [must be] aware of the discharge injunction **and** aware that it applied to his or her claim." *Shaw*, 2017 WL 2791663, at *5 (bold emphasis in original); *Taggart I*, 548 B.R. at 288 (stating same). The Bankruptcy Court overlooked the latter requirement because Appellants argued at length that the discharge injunction did not apply to the Standstill Agreement, a position which could indicate that Appellants may not believe that the discharge injunction applies to their claims. *See* ER at 97–112 (opposition to motion for contempt arguing at length that the Standstill Agreement is not subject to the discharge injunction); Appellants' Br. 8–13 (repeating similar arguments here).

To be clear, the Bankruptcy Court could certainly have found that despite Appellants' arguments, Appellants were in fact aware that the discharge injunction applied to Appellants' claims. As Appellee points out, Appellants filed a notice of

special appearance before the Bankruptcy Court, the order discharging Appellee from bankruptcy was served on Appellants, and Appellants amended their complaint in the state court suit to plead around the discharge once Appellants were informed that their initial complaint violated the discharge injunction. ER 155, 168–71, 180–81. Nonetheless, it does not appear from the record that the Bankruptcy Court found that Appellants were aware that the discharge injunction applied to Appellants' claims.

By finding only that Appellants knew of the discharge injunction, but not that Appellants were aware of the discharge injunction's applicability, the Bankruptcy Court did not apply the correct legal standard for finding Appellants in contempt. *Taggart II*, 888 F.3d at 444 ("[T]he bankruptcy court abused its discretion by applying an incorrect rule of law."). The Bankruptcy Court therefore abused its discretion. *See Perry v. Brown*, 667 F.3d 1078, 1084 (9th Cir. 2012) ("[A]n error of law constitutes an abuse of discretion.").

Underscoring the point, both *Taggart* and *Shaw* reversed contempt sanctions on strikingly similar facts. In *Taggart*, a group of creditors knew of the debtor's discharge but nonetheless sought attorneys' fees based on "a good faith belief that the discharge injunction did not apply to their claims ... " *Taggart II*, 888 F.3d at 444. The Bankruptcy Court still imposed contempt sanctions on the creditors because it "concluded that it was irrelevant whether the Creditors held a subjective good faith belief that the discharge injunction did not apply to their claim." *Id.* at 443. The Bankruptcy Appellate Panel ("BAP") subsequently reversed the bankruptcy court, and the Ninth Circuit affirmed the BAP. *Id.* at

444. The Ninth Circuit agreed that the creditors' belief that the discharge injunction did not apply was incorrect but nevertheless found that the creditors' "good faith belief, even if unreasonable, insulated them from a finding of contempt." *Id.*

In a similar vein, *Shaw* reversed a bankruptcy court's imposition of sanctions on a creditor for a violation of the discharge injunction because the BAP found the bankruptcy court had conflated the creditor's undisputed knowledge of the injunction's existence with the creditor's knowledge of its applicability and had failed to make "any finding as to whether she knew the discharge injunction 'applied' to her causes of action in the FAC." *Shaw*, 2017 WL 2791663, at *5.

There is also a second, independent basis for vacating the sanctions award. Even assuming *arguendo* that the Bankruptcy Court's decision could be construed as finding that Appellants knew the discharge injunction was applicable, Appellants are correct to argue that an evidentiary hearing would be required to resolve that contested question of fact. Both the Ninth Circuit and BAP have so held. *Zilog*, 450 F.3d at 1008 (Ninth Circuit decision stating that "[i]f, as here, the creditors dispute that they had such knowledge [of the injunction], a finding that they knew of the injunction, and thus willfully violated it, can only be made after an evidentiary hearing."); *Shaw*, 2017 WL 2791663, at*6 (BAP decision finding that "since [the creditor] disputed that the discharge injunction applied to any of her causes of action in the FAC, the bankruptcy court was required to hold an evidentiary hearing, which it did not do."). This too compels reversal.

In sum, the Bankruptcy Court abused its discretion by failing to make a finding that the creditors were aware the discharge injunction applied to their claims and by failing to conduct an evidentiary hearing.

## IV. CONCLUSION

For the foregoing reasons, the Court VACATES the Bankruptcy Court's order finding Appellants in contempt and the Bankruptcy Court's order awarding Appellee $19,247.74 in attorney's fees and costs and REMANDS for reconsideration of the sanctions award. On remand, the Bankruptcy Court may find Appellants in contempt and impose appropriate sanctions such as attorney's fees and costs or punitive damages once the Bankruptcy Court has held an evidentiary hearing and applied the legal standard.

**IT IS SO ORDERED.**

Dated: July 25, 2018
*/s/ Lucy H. Koh*
LUCY H. KOH
United States District Judge